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SIPDIS

SENSITIVE

STATE FOR E, P, EUR/SE AND EB  
TREASURY FOR U/S TAYLOR AND OASIA - MILLS  
NSC FOR QUANRUD AND BRYZA

E.O. 12958: N/A

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SUBJECT: TURKISH ECONOMY MARCH 31: PROGRESS ON IMF FOURTH REVIEW

Sensitive but unclassified, and not for internet distribution.

11. (SBU) Summary: The parliament passed the 2003 budget, and AK dropped a controversial amendment to the Public Procurement Law after the IMF complained, according to Turkish press. Ahead of the April 8 debt auction and April 9 \$3 billion debt payment, markets expect an LOI signing and IMF Fourth Review board date. The GOT should be in a position to sign the LOI this week. Further good news came in final 2002 GNP numbers showing 7.8 percent growth. At the same time, however, AK leaders to continue send populist signals contrary to the fiscal austerity message the markets need to hear. End Summary.

Markets Improve For End Of Quarter; Focus on IMF  
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12. (U) In morning trading March 31, Turkish banks worked to boost the value of T-bills and the lira, to improve their end of first quarter results. The benchmark T-bill fell to 64.7 percent (down nearly one percentage point from Friday's close); the lira strengthened slightly to TL 1,704,000 to the dollar; the Istanbul Stock Exchange was down 1.3 percent in light trading.

13. (SBU) Ahead of the April 8 debt auction and April 9 \$3 billion debt payment, markets expect to hear good news on the IMF Fourth Review (see below), and hope not to hear bad news on Congressional approval of the U.S. package. Markets believe the GOT will successfully roll-over the debt on April 8 (discounted yields on the April 9 bill reflect this confidence). Looking forward, however, sentiment remain very negative. ING Barings General Manager in Turkey told us his bank estimates Turkey's default risk at 30 percent in 2004, based mainly on incompetence of the AK government in handling its ever increasing debt burden.

Final GNP Data Shows Strong Recovery in  
2002; A Different Story Expected for 2003  
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14. (U) On March 31, the State Statistics Institute released 2002 fourth quarter and full-year data: GNP growth for 2002 was 7.8 percent; fourth quarter growth, compared with the fourth quarter 2001, was 11.5 percent. In lira terms, GNP in 2002 was TL 273.5 quadrillion. In dollar terms, GNP was about \$171 billion and per capita GNP was \$2,584.

15. (SBU) Comment: Former President Suleiman Demirel's famous saying, "Yesterday was yesterday, today is today," seems appropriate. Strong growth in 2002 had two main elements: inventory rebuilding/bouncing back after a 9.5 percent contraction in 2001; a pick-up of exports. Looking ahead, the growth story should be based more on the return of domestic demand. However, consumer and investor confidence surveys do not indicate strong demand. Private sector banks and market analysts predict 2003 growth in the 1-3.5 percent range, all under the GOT's target of 5 percent. End Comment.

Progress on IMF Fourth Review:  
Budget Adopted Without Problem Amendments  
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16. (SBU) On March 29, the parliament passed the full-year 2003 budget, and the AK Party dropped a proposed amendment to the budget law which would have exempted state energy

companies from the provisions of the new Public Procurement Law. World Bank economist Parks told us the Bank advised the GOT to follow the EU practice on energy sector procurements (the EU has a separate directive for government procurement for commercial transactions in certain sectors, including energy, telecom, transportation).

17. (SBU) According to the World Bank, the GOT is moving forward on the other three main prior actions for the IMF Fourth Review in addition to the budget:

-- Privatization Administration chief Bozkurt told the Bank that the High Privatization Council had approved the TEKEL privatization plan.

-- The direct tax reform bill is scheduled to be voted by parliament's Budget and Planning Commission this week.

-- On eliminating redundancies in the state enterprises, the prime ministry issued a directive to all ministries canceling earlier prohibitions on forced retirement; and the Prime Minister is scheduled to announce this week the targets for lay-offs in SEEs over the remainder of year.

18. (SBU) Comment: The GOT needs to sign the LOI and have the IMF announce a 4th Review board date this week, ahead of the large April 8 debt auction. Deputy PM Sener told local TV news that the LOI would be signed this week. At the same time, however, AK leaders continue to undercut this fiscal austerity message, key to market confidence, with populist signals to their constituents. Thus, Sener in the same interview said farmers would not have to pay interest on outstanding loans from state bank Ziraat (appears to contradict an LOI undertaking). MinState Babacan told the press that AK was studying the possibility of adding an Islamic-type non-interest loan facility to the state banks. Newly appointed Ziraat Bank GM Caglar later said this would take at least two years to implement, but for Turkey's secular-oriented financial markets, this was another reason to remain skeptical of GOT fiscal commitments.

PEARSON